SUPREME COURT, U. S.

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In the

SUPREME COURT OF THE UNITED STATES

October Term, 1967

No. 847

CARLOS AND JACQUELINE MARCELLO,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

JACK WASSERMAN
Warner Building
Washington, D. C.

DE QUINCY V. SUTTON
401 Greater Mississippi Life Bldg.
Meridian, Mississippi

Attorneys for Petitioners

Washington, D. C. - THIEL PRESS - 202 - 393-0625

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Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit affirming in part and remanding in part a decision of the Tax Court of the United States.

OPINIONS BELOW

The opinion of the Court of Appeals has not yet been reported and is set forth in the Appendix A. The relevant portions of the opinion of the Tax Court are set forth in Appendix D.

JURISDICTION

The judgment of the Court of Appeals was entered on June 16, 1967 (Appendix B). A petition for rehearing was denied on August 29, 1967 (Appendix C). Jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether deportation expenses of petitioners in 1957 and 1958 resulting from a 1938 conviction for the unlawful sale of marihuana are deductible in conformity with *Commissioner v. Tellier*, 383 U.S. 687 (1966), and 26 U.S.C. 162(a) and 212, as ordinary and necessary expenses incurred for the production and collection of income.

2. Whether deportation expenses incurred in 1957 and 1958 to prevent expulsion from the United States and termination of the salary of petitioner, Carlos Marcello, is an ordinary and necessary expense deductible under *Commissioner v. Heninger*, 320 U.S. 467 (1943), and 26 U.S.C. 162 (a).

3. Whether petitioners were assessed the full gain on the sale in 1958 of their former residence, contrary to 26 U.S.C. 1034(a), where it clearly appears that a new residence was purchased by them within the same year but title to the same was taken in the name of a close relative who simultaneous with the purchase acknowledged under oath that title was actually in petitioners.

4. Whether for tax purposes the Internal Revenue Service is required to give effect to the law of the State of Louisiana which recognizes petitioners as the owners of the new residence purchased in 1958.

STATUTES INVOLVED

Section 162(a) of the Internal Revenue Code of 1954 [26 U.S.C. 162(a)] provides in part:

> "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *."

Section 212 of the Internal Revenue Code of 1954 (26 U.S.C. 212) provides in part:

> "In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year -
>
> (1) for the production or collection of income
>
> (2) for the management, conservation, or maintenance of property held for the production of income or * * *."

Section 1034(a) of the Internal Revenue Code of 1954 [26 U.S.C. 1034(a)] provides in part:

> "If property (in this section called 'old residence') used by the taxpayer as his principal residence is sold by him after December 31, 1953, and within a period beginning 1 year before the date of such sale and ending 1 year after such date, property (in this section called 'new residence') is purchased and used by the taxpayer as his principal residence, gain (if any) from such sale shall be recognized only to the extent that the taxpayer's adjusted sales price * * * of the old residence exceeds the taxpayer's cost of purchasing the new residence."

Article 2236 of the Louisiana Civil Code provides:

> "The authentic act is full proof of the agreement contained in it, against the contracting parties and their heirs or assigns unless it be declared and proved a forgery."

Article 2239 of the Louisiana Civil Code provides:

> "Counter letters can have no effect against creditors or bona fide purchasers; they are valid as to all others * * *."

Article 2264 of the Louisiana Civil Code provides:

> "No notarial act concerning immovable property shall have any effect against third parties, until the same shall have been deposited in the office of the parish recorder, or register of conveyances of the parish where such immovable property is situated."

Article 2266 of the Louisiana Civil Code provides:

> "All sales, contracts, and judgments affecting immovable property, which shall not be so recorded, shall be utterly null and void, except between the parties thereto. The recording may be made at any time but shall only affect third persons from the time of the recording."

STATEMENT

The courts below disallowed tax deductions of counsel fees paid by petitioners for the years 1957 and 1958 in resisting the deportation of Carlos Marcello. They also included for 1958 the gain on the sale of petitioners' home of $59,463.00, refusing to apply 26 U.S.C. 1034(a) in connection with the purchase and use of another home in Louisiana in the same year.

In 1938 Carlos Marcello was indicted and convicted for making two sales of marihuana in 1937 without written orders in violation of 26 U.S.C. 1399(e) and (g).[1] His sentence was a year and a day. By retroactive legislation enacted fourteen years later in 1952 [8 U.S.C. 1251(a)(11)] Marcello became subject to deportation on the basis of the 1938 conviction. *Marcello v. Bonds*, 349 U.S. 302, 313 (1954). Marcello continued to fight his removal from the United States from 1953 to the present time. On April 4, 1961, Marcello was briefly and illegally removed to Guatemala by

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[1] See: *United States v. Marcello*, 202 F. Supp. 694 (S.D. La., 1962), affirmed, 328 F.2d 961 (5th Cir., 1964), cert. denied, 377 U.S. 992 (1964).

the Immigration Service. The Commissioner of Internal Revenue on April 7, 1961, declared that he had departed without paying his taxes and entered a jeopardy assessment of $811,312.63. This was withdrawn when litigation was instituted challenging this arbitrary action. *Marcello v. Caplin* (Civil Action 1126-61, U.S. Dist. Ct., Dist. of Col.). Marcello returned to the United States in 1961 and he is again being subjected to deportation proceedings based upon his 1938 conviction.[2]

In 1957 and 1958 Marcello expended attorneys fees of $8,708.27 (R. 69) principally in defense of his deportation case.[3] The Tax Court found that these deportation expenses were personal and not deductible (R. 82). The Court below affirmed (R. 159-160).

Petitioners sold their residence in 1958 for $101,963.85, realizing a profit of $59,463.00. On March 31, 1958, the mother of Carlos Marcello, Louisa Marcello, purchased in her name a residence in Metairie, Louisiana, for $110,000.00. In a notarized affidavit dated the same day as the purchase, Louisa Marcello acknowledged that the property was placed in her name for convenience only and that the property was bought and paid for the account of Carlos Marcello (R. 154, 214). The house was paid for by petitioners, was used as the residence of petitioners, and the periodic payments of principal and interest were made by petitioners (R. 67, 68, 79). The Tax Court ruled that the affidavit of Louisa Marcello was not a counter-letter[4] under Louisiana law and that since it had not been recorded it had no probative value. It,

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[2]The Immigration Service contends that Marcello is an Italian citizen, but the Italian Government will not accept him as a deportee. No other country is willing to receive him.

[3]$1,000.00 for his tax matters was allowed by the Tax Court (R. 82).

[4]A counter-letter is a defeasance by a separate instrument or an agreement to reconvey. *Louis v. Garrison*, 64 So. 2d 254 (1953).

therefore, refused to accord petitioners the benefits of 26 U.S.C. 1034 (R. 80). The Court below agreed that petitioners had not established their ownership of the home purchased in 1958 (R. 154-156). The profit of $59,463.00 was accordingly assessed against petitioners and interest payments on the new residence were likewise disallowed (R. 78-82).

REASONS FOR GRANTING THE WRIT

1. The decisions below are contrary to *Commissioner v. Tellier*, 383 U.S. 687 (1966), and *United States v. Gilmore*, 372 U.S. 39 (1963), and misinterpret 26 U.S.C. 162(a) and 26 U.S.C. 212. It is apparent that the origin and character of the claim with respect to which the expense was incurred was the desire and attempt to produce income from the sale of marihuana. This resulted in a conviction in 1938. The expense of defending the criminal case in 1938 would have been deductible under *Commissioner v. Tellier, supra*. The conviction resulted in deportation proceedings which produced deductible tax expenses in 1957 and 1958.

The deportation penalty was superimposed retroactively as an additional sanction for Marcello's unlawful sale of marihuana for profit in 1937. The fact that the expenses herein had their origin in unlawful sales do not require their disallowance, *Commissioner v. Tellier, supra*. Moreover, the courts below did not base disallowance on such ground. The sole basis was that deportation expenses are personal and not deductible. Here, where the origin of deportation expenses derive from unlawful sales for profit which form the basis of deportation proceedings, they should be considered deductible.[5]

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[5]It is not without significance that deportation would have effectively terminated all salaries received by Marcello from the Jefferson Music Company and other income dependent upon his presence in the United States. We submit that under *Commissioner v. Heninger*, 320 U.S. 467 (1943), these deportation expenses are deductible.

2. The decisions below likewise erroneously interpret 26 U.S.C. 1034(a). Despite the contemporaneous declaration under oath by Louisa Marcello, that the house she purchased in 1958 in her name was actually for her son and daughter-in-law, the petitioners herein, despite her solemn statement[6] that actual title was in petitioners who paid for, lived in, used the residence, and made the mortgage payments thereon (R. 67, 68, 79, 154, 214), the Tax Court required recordation as a prerequisite to recognition (R. 80). It also refused to accord the Louisa Marcello affidavit effect as a counter-letter. The Court of Appeals affirmed, stating (R. 157, note 7):

> "We merely hold that this unrecorded affidavit does not justify a claim that the affidavit's beneficiary, Carlos, is a purchaser who can take advantage of section 1034."

The decisions below fail to accord proper recognition to property rights created under Louisiana law. State law controls the disposition and rules governing the ownership of real property. *United States v. Fox*, 94 U.S. 315, 320-21 (1876); *Sunderland v. United States*, 266 U.S. 226, 232-33 (1924). The courts below were concerned without cause with the fact that petitioners might not be able to assert their claim of title against bona fide purchasers, a situation not presented here. It is clear that as between petitioners and Louisa Marcello, petitioners were in fact the owners of the new residence purchased in 1958. Under Louisiana law the contemporaneous affidavit of Louisa Marcello, whether considered a counter-letter or not, was a solemn obligation to reconvey title to petitioners and a recognition of ownership in petitioners. *Louis v. Garrison*, 64 So. 2d 254 (1953). As between Louisa Marcello and petitioners, it was not necessary to record the affidavit to give it validity.

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[6]The notarized statement of Louisa Marcello is an authentic act under Louisiana law and is full proof of the agreement between the parties. Louisiana Civil Code, Articles 2234 and 2236.

Louisiana Civil Code, Article 2266. The courts below misinterpreted 26 U.S.C. 1034 by disregarding the effect of Louisiana law and by erroneously ignoring the equitable and actual owners of the new residence herein. Proper construction of this important section of our tax laws warrants the grant of certiorari herein.

CONCLUSION

The issues raised by the decisions below are of such continuing importance in the administration of our tax laws that a writ of certiorari should be granted.

Respectfully submitted,

JACK WASSERMAN
Warner Building
Washington, D. C.

DE QUINCY V. SUTTON
401 Greater Mississippi Life Bldg.
Meridian, Mississippi

Attorneys for Petitioner

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 23152

CARLOS & JACQUELINE MARCELLO, ET AL.,
Petitioners,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 23153

JOSEPH, JR. & ANASTASIA MARCELLO,
Petitioners,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petitions for Review of Decisions of the Tax Court of the United States. (Louisiana Case)

(June 16, 1967.)

Before RIVES, COLEMAN and GODBOLD, Circuit Judges.

RIVES, Circuit Judge: The taxpayers seek a review of a Tax Court decision holding each of them liable

for deficiencies in income tax and some of them liable for penalties pursuant to Sections 6651(a) and 6653(a) of the 1954 Internal Revenue Code.[1] There are seven distinct and unrelated issues involved. To facilitate our disposition of this case, we take up each matter separately.

I. Recognition of Gain on the Sale of Carlos and Jacqueline Marcello's Residence.

Carlos Marcello purchased a residence in July 1946 for $42,500 and sold it in December 1958 for $101,963.85. An Act of Sale, dated March 31, 1958, reflects that Louisa Marcello, Carlos' mother, purchased in her name a residence in Metairie, Louisiana, for $110,000. Louisa in a notarized affidavit deposed that the title to this property was placed in her name for convenience only; that the property was bought by and for the account of Carlos Marcello; that Carlos paid the purchase price; that she agreed to bind herself, her heirs, executors and administrators to convey such property to Carlos, his heirs, executors and assigns whenever required to do so; and that, in making such conveyance to Carlos, no consideration is to be paid though one might be stipulated and declared to be paid in the deed of conveyance.

[1] The two cases are the second and third of four related cases involving the Marcello family. The other two, also decided this day, are Vincent and Sadie Marcello v. Commissioner, No. 23151, and Peter J. and Penny Marcello v. Commissioner, No. 23154.

Section 1034 (a) of the 1954 Internal Revenue Code, 26 U.S.C.A. § 1034 (a), provides that if within a year before or after the sale of a taxpayer's residence, the taxpayer purchases and uses a new residence, the gain on the sale of the old residence to the extent of the cost of purchasing the new residence is not recognized.[2]

The Tax Court held that Carlos and Jacqueline failed to prove that they purchased the new residence. Though the Tax Court found that Carlos made periodic mortgage payments for the new residence, it did not find that these payments were for his purchase of the new house. Neither was there a finding that Carlos and Jacqueline made an initial down payment, as claimed by the taxpayers. The Commissioner suggests that the mortgage payments could either have been means of paying rent to Louisa or repayments of a loan.[3] We do not speculate on the reasons Carlos made these mortgage payments. We do agree, however, with the Tax Court that within the meaning of Section 1034 Carlos was not the purchaser of the new residence.

The aim of Section 1034 is not to ignore the realization of gain but only to postpone recognition thereof and to defer the tax.[4] A taxpayer is not entitled to the postponement benefit unless he purchases a new

[2] See 3 Mertens, Law of Federal Income Taxation §§ 20.182-20.191.

[3] The Commissioner points out that Carlos owed his mother $35,000.

[4] The nonrecognized gain may become taxable when the new residence is sold or disposed of. 3 Mertens, Law of Federal Income Taxation § 20.182.

residence within the subscribed time period. Congress intended to enable homeowners to use the sales proceeds from a sale of the old residence for buying their own home. The purpose of Section 1034 was not to permit a taxpayer to re-invest the proceeds from the sale of his home in the home of another person without recognizing for federal income tax purposes the gain realized by the sale.[5] The clear statutory language requires that a new residence be *purchased* and *used* by the taxpayer. That the residence must be owned by the taxpayer is made evident by the exception in subsection (g) of Section 1034 permitting either the husband or the wife to hold the residence in his or her name.[6] If a third party owns the residence, the "purchase requirements are not met.[7]

II. Interest Expenses of Carlos and Salvador's Motel.

Carlos Marcello and Salvador Marcello, along with two other persons, operated as partners the Town

[5] See Rev. Rul. 55-37, Cum. Bull. 1955-1, pp. 347, 348.

[6] See Section 1034 (f), I.R.C. 1954, 26 U.S.C.A. § 1034 (f), providing, in effect, that holders' stock in a cooperative housing corporation are eligible for the benefits of subsection (a), assuming the occupancy prerequisite is met.

[7] We would be persuaded to find for the taxpayer if he had purchased legal title within the prescribed period. Reg. § 1.1034-1 (c)(3)(i); Joint Committee Staff Summary of Provisions of the Revenue Act of 1951, Cum. Bull. 1951-2, pp. 287, 309. See Mertens, Law of Federal Income Taxation §20.185.

The fact that Carlos was beneficiary under an affidavit purporting to set up a trust relationship does not make him a purchaser of the property. There may be situations where a beneficiary of a trust document is a purchaser. For example, a taxpayer may have a recorded title subject to a duly

and Country Motel. The Commissioner disallowed certain deductions taken by the partnership and thereby increased the distributive share to Carlos and Salvador.

The Tax Court, applying the so-called Cohan[8] rule, found that the partnership was entitled to deductions for interest expenses in the amount of $5,000 for each taxable year ending January 31, 1956, 1957, 1958 and 1959.[9] Specifically, the Tax Court found that the taxpayers did not support their claim for the full amount deducted:

> "While there are a number of loans made by the partnership which actually relate to its business, there is a failure of proof in establishing a connection between a particular interest payment, the loan on which it is being made, and whether or not that loan is connected with the business of the motel. Even as to those loans which were shown to

recorded deed of trust or mortgage. Though according to state law, the taxpayer's title may be denominated "equitable" and the title of the trustee or mortgagee considered to be "legal", we have no doubt that section 1034 would be applicable. The facts of this case reveal that Louisa and Carlos could ignore the unrecorded affidavit, permit Louisa to sell the property in her name to a third party, and thereby possibly avoid Carlos' capital gain. We do not speculate whether an attempt to avoid the tax would have occurred or even if the gain would actually go unrecognized. We merely hold that this unrecorded affidavit does not justify a claim that the affidavit's beneficiary, Carlos, is a purchaser who can take advantage of section 1034.

[8] Cohan v. Commissioner, 2 Cir. 1930, 39 F.2d 540.

[9] The partnership had deducted $7,581.37 (1956); $8,644.22 (1957); $12,444.42 (1958); and $5,055.18 (1959). Carlos and Salvador do not appeal the disallowance of deductions taken for travel and entertainment expenses.

be related to the motel's business, we are unable to ascertain the exact amounts of interest paid during the years involved."

We find that the Tax Court made a correct estimate of what interest was attributable to partnership borrowings.[10]

III. The Section 6651(a) Penalty Assessed Against Carlos and Jacqueline Marcello.

Carlos and Jacqueline Marcello filed their 1959 joint tax return late, thereby incurring a penalty pursuant to Section 6651(a) of the 1954 Internal Revenue Code. That section provides for a 5% penalty of the tax owed for each month or fraction thereof that the return is filed late. The Commissioner determined that the return was one month and three days late, so that the penalty is 10%. The taxpayers contend that the return was less than one month late, so that the penalty should be 5%. We agree with the Commissioner that the procrastination cost the taxpayers a two-month penalty.

As a result of a properly granted extension, Carlos and Jacqueline had until September 15, 1960, to file their 1959 joint return. They desired even more time to prepare their return. In a letter dated September 23, 1960, their local district director refused

[10] The taxpayers, Carlos and Salvador, contend that it makes no difference whether the loans were to the partnership or to individual partners, on the theory that partnership expenses are deductions to the partners in the long run. This argument is clearly wrong. The interest expense of partner A cannot be deducted by the partnership so as to lessen the taxable income of partner B.

the request for a further extension, but did advise the taxpayers that the return would be considered timely filed if it were received by his office within ten days of the date of the letter. The return was not filed until October 18, 1960, one month and three days after the September 15 filing date.

The taxpayers contend that the ten-day grace period extended their filing date to October 3. They assume that the district director's letter was an extension of time for filing a return within the meaning of Section 6081(a). Their assumption is wrong. The director expressly refused to grant an extension beyond September 15. Exercising his discretion, he, in effect, said that he would not invoke the sanctions of § 6651(a) if the return was filed within ten days. The taxpayers, though not adhering to the conditions of that offer, still wish to reap its benefits. This we do not permit. The logical extension of the taxpayers' argument leads to an unacceptable result. Under their theory, the filing became overdue as of October 3. They thereby would obtain an eighteen-day extension.[11] Surely the district director did not intend or contemplate such a result. We find no such extension to be warranted by the facts. In short, the taxpayers have not shown that their failure to file was due to reasonable cause.[12]

IV. Carlos Marcello's Attorney Fees.

Carlos and Jacqueline deducted certain attorney fees as expenses within the meaning of Sections

[11] September 15 to October 3.

[12] Logan Lumber Co. v. Commissioner, 5 Cir. 1966, 365 F.2d 846; Breland v. United States, 5 Cir. 1963, 323 F.2d 492, 497. See 3 A.L.R. 2d 617 for a discussion on what amounts to "reasonable cause" for failure to file tax returns.

162(a) and 212 of the 1954 Internal Revenue Act. The Commissioner disallowed the deductions on the grounds that the expenditures were neither business expenses nor incurred in the production or collection of income.

The involved fees were paid by Carlos in 1957 and 1958 in resisting deportation. The taxpayers claim that these fees were directly related to Carlos's numerous and rather intricate business ventures in Louisiana. In their brief, the taxpayers insinuate that the deportation proceedings were motivated by alleged illegal activities committed by Carlos as a partner in one of his sundry businesses. There is no evidence in the record, however, that the deportation action originated out of any business or income-producing transactions.[13] When a taxpayer claims a Section 162(a) deduction, he has the burden to prove that the expense in question has a business origin.[14] If the expenses are of a personal nature, there may be no deduction pursuant to Section 162(a).[15]

[13] See Commissioner v. Tellier, 1966, 383 U.S. 687; Gilmore v. United States, 1962, 372 U.S. 39; United States v. Patrick, 1963, 372 U.S. 53; United States v. Omaha Line Stock Traders Exchange, 8 Cir. 1966, 366 F.2d 749; Finger v. United States, D. S.C. 1966, 257 F. Supp. 312. Cf. Commissioner v. Heininger, 1943, 320 U.S. 467; see also Lilly v. Commissioner, 1951, 343 U.S. 90.

[14] Cf. Interstate Transit Lines v. Commissioner, 1942, 319 U.S. 590, 593; Peckham v. Commissioner, 4 Cir. 1964, 327 F.2d 855; Finger v. United States, D. S.C. 1966, 257 F. Supp. 312.

[15] For a distinction between a private wrongdoing as opposed to a public wrongdoing, see Cornelius Vanderbilt, Jr., T.C. Memo 1957-235. See Rev. Rule 66-330, 1966 I.R.B.-45, p. 5; 4A Mertens, Law of Federal Income Taxation § 25.50.

There is a further contention that deportation was vigorously resisted not because Carlos enjoyed the comforts and sanctity of the United States, but so that he could personally operate his businesses and conserve his income-producing property. The taxpayer's argument has no merit. In *Commissioner v. Tellier*, 1966, 383 U.S. 687, 689, the Supreme Court, quoting from *United States v. Gilmore*, 1962, 372 U.S. 39, noted that "origin and character of the claim with respect to which an expense was incurred, *rather than its potential consequences upon the fortunes of the taxpayer* is the controlling basic test of whether the expense was 'business' or 'personal' within the meaning of § 162 (a)." (Emphasis added.) If the taxpayers were correct, then even expense incurred in resisting a murder charge could be a business expense on the theory that incarcerapreme Court of Louisiana entitled *"City of Hammond* tion would take the defendant away from his business location. We refuse to travel to such a destination.[16]

V. Carlos and Jacqueline Marcello's Personal Expenses.

The Commissioner disallowed as deductions numerous expenses incurred by Carlos and Jacqueline Marcello on the ground that they were not business

[16] The Tax Court found that the deportation proceedings were not connected with Carlos's business. This second contention must fall, therefore, for the additional reason that the Tax Court's finding that the expenditure was not directly related to the taxpayer's business was a finding of fact not shown to be clearly erroneous. See 26 U.S.C.A. 7482; Commissioner v. Heininger, 1943, 320 U.S. 467, 475.

expenses. We agree with the Tax Court's conclusion that "There is nothing upon which we can base a conclusion that [Carlos's] expenses were unreimbursed business expenses."[17]

VI. Penalties Assessed Pursuant to

Various members of the Marcello family were assessed with a 5% penalty pursuant to Section 6653(a) of the 1954 Internal Revenue Code.[18] With regard to Salvador Marcello, the Tax Court found that his failure in 1958 and 1959 to properly report his proportionate share of partnership income was due to negligence and, further, that he was partly responsible for the partnership's failure to keep adequate records. The Tax Court found that Joseph Marcello, Jr. failed to keep adequate records of his business expenditures and that the overstatement of corresponding deductions on his 1958 tax return was due to negligence. Finally, the Tax Court held that, as to Vincent Marcello, the presumption of correctness attributed to the Commissioner's determination

[17] See Welch v. Helvering, 1933, 290 U.S. 111; Mayrath v. Commissioner, 5 Cir. 1966, 357 F.2d 209. Cf. Kornhauser v. United States, 1928, 276 U.S. 145; New Colonial Ice Co. v. Helvering, 1934, 292 U.S. 435; Helvering v. Taylor, 1935, 293 U.S. 507; Interstate Transit Lines v. Commissioner, 1942, 319 U.S. 590.

[18] Section 6653. Failure to Pay Tax.

"(a) *Negligence or Intentional Disregard of Rules and Regulations with Respect to Income or Gift Taxes.*—If any part of any underpayment (as defined in subsection (c)(1)) of any tax imposed by subtitle A or by Chapter 12 of subtitle B (relating to income taxes and gift taxes) is due to negligence or intentional disregard to rules and regulations (but without intent to defraud), there shall be added to the tax an amount equal to 5 per cent of the underpayment."

had not been overcome and, therefore, the penalty must be sustained.

The taxpayers advanced a three-pronged attack on the Tax Court findings. In capsule form, their arguments are that (a) the facts do not support a holding that the taxpayers *intended* to disregard rules and regulations; (b) the *Commissioner* has the burden to show an intent to disregard rules and regulations; and (c) since Section 6653(a) is worded in the disjunctive, the Commissioner must indicate on the statutory deficiency notice which violation allegedly occurred.

The Commissioner parries with the claim that the taxpayers bear the burden to show that no negligence or intentional disregard of rules and regulations occurred. The Commissioner suggests that intent can be exhibited either by circumstantial evidence or by presuming the correctness of the Commissioner's determination.

Sweeping aside the various overlapping arguments offered by the taxpayers, we observe that their real complaint is that in the deficiency notice the Commissioner merely cited Section 6653(a) without denoting what elements of the section were violated. The taxpayer's argument, as we understand it, proposes that a taxpayer cannot adequately and properly defend against the assessment of a Section 6653(a) penalty unless he knows upon what part or parts of the section the Commissioner relies. This argument assumes that the Commissioner has the burden if he asserts a violation of the latter part,

while the taxpayer has the burden only if the Commissioner asserts a violation of the first part.

There is no dispute that the taxpayer has the burden if he is accused of being negligent in regard to the making out of his tax return.[19] The authorities indicate that the taxpayer also has the burden to show that he did not intentionally disregard rules and regulations.[20] The latter segment of the disjunctive clause is usually brought into play when a taxpayer who is aware or should be aware of a rule or regulation chooses to ignore its requirements.[21] The taxpayer can avoid the penalty by showing no intent to disregard the rule or regulations involved.[22]

[19] Gibbs v. Tomlinson, 5 Cir. 1966, 362 F.2d 394; Lusk v. Commissioner, 7 Cir. 1957, 250 F.2d 591, *cert.den.*, 357 U.S. 932; Boynton v. Pedrick, 2 Cir. 1955, 228 F.2d 745; David Courtney, 28 T.C. 658 (1957). Balter, *Tax Fraud and Tax Evasion* § 8.2-3. See Niles Bement Pond Co. v. U.S., 1930, 281 U.S. 357.

[20] Boynton v. Pedrick, 2 Cir. 1955, 228 F.2d 745, *cert.den.*, 351 U.S. 938, *rehearing den.*, 351 U.S. 990; Jacobs v. United States, Ct.Cl. 1954, 126 F.Supp. 154, 159. See 10 Mertens, Law of Federal Income Taxation § 55.25; Balter, *Tax Fraud and Tax Evasion* §§ 8.2-3, 10.4-4. Cf. Helvering v. Mitchell, 1938, 303 U.S. 391. Where the Commissioner asserts a fraud penalty pursuant to Section 6653(b), he has the burden of proving that the facts warrant the imposition of that penalty. Section 7454(a). The intent of Section 6653(a) may be discerned from the failure of the taxpayer to do what the rule or regulation requires. The penalty may be avoided by the taxpayer showing that he had no intent to disregard rules or regulations or by excusing his actions with an acceptable and justified reason, such as have been accepted by courts in the past. See Nessen, "The Line Between Negligence and Civil Fraud: The Operation of Two Penalty Provisions Against Underpaying Taxpayers," 20 N.Y.U. Inst. on Fed. Tax. 1117.

[21] In Journal Co., 46 B.T.A. 841; George G. Ebner, T.C. Memo 1958-108; Rudolph A. Zivnuska, 33 T.C. 226 (1959).

[22] Admittedly, this is extremely difficult. Recognizing the problem faced by the taxpayer who has the burden to show he had no intent to disregard rules or regulations, the Senate Finance Committee in 1954 proposed an amendment to what

The penalty may possibly be avoided if the taxpayer because of a mistaken conception of his legal rights failed to follow the rules or regulations.[23] Negligence is lack of due care or failure to do what a reasonable and ordinarily prudent person would do under the circumstances.[24] Thus, a taxpayer may not be negligent but still intentionally disregard rules and regulations, thereby violating Section 6653(a).

We now reach the crux of the problem. If the taxpayer has the burden regardless of which element of Section 6653(a) is the basis of the assessment, need the Commissioner do more than merely cite that section in his deficiency notice? In this case, the Commissioner relied on both segments of the section.[25] He need not have quoted the section

is now Section 6653(a). The amendment provided that the penalty would not be imposed where the taxpayer intentionally disregarded rules and regulations because of a belief of their invalidity. To avoid the penalty, however, the amendment made it incumbent upon the taxpayer to attach to his return an adequate statement setting forth the rules and regulations disregarded and the grounds for believing them to be invalid. See Sen. Rep. No. 1622, 83rd Cong., 2nd sess., p. 591; U.S. Code Cong. & Ad. News, 83rd Cong., 2nd sess., pp. 4781, 5240. This amendment was deleted in conference. H. Rep. No. 2543, 83rd Cong., 2nd sess., p. 80; U.S. Code Cong. & Ad. News, 83rd Cong., 2nd sess., p. 5342.

[23] See Bennett v. Commissioner, 8 Cir. 1944, 139 F.2d 961.

[24] Southeastern Finance Co. v. Commissioner, 5 Cir. 1946, 152 F.2d 205. Cf. Evans v. Commissioner, 8 Cir. 1956, 235 F.2d 586, *cert. den.*, 352 U.S. 909.

[25] If the Commissioner has one part in mind, certainly he should, and most likely he would, expressly indicate it. Most commentators on the subject note that the Commissioner rarely assesses a penalty for intentional disregard for rules and regulations. There is some suggestion, therefore, that citing Section 6653(a) in the deficiency notice, in reality, means an assessment of a penalty for negligence. Balter, "The Line Between Negligence and Fraud," 12 N.Y.U. Inst. of Fed. Tax. 15, 39. Hoffman, "International Disregard of Rules and Regulations," 28 Taxes 111 (1950).

verbatim. Citing the appropriate section number was sufficient to notify the taxpayers that the 5% addition to their taxes was for violating both segments of Section 6653(a).[26] The taxpayers had the burden to show that their underpayment was due neither to negligence nor intent to disregard rules and regulations.[27]

As for the Tax Court's specific findings that the taxpayers negligently understated their taxable income, we find no error. On the contrary, the record shows a failure to keep books and documents necessary to form a rational basis for the income reported and the expenses deducted.[28]

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[26] Balter, *Tax Fraud and Tax Evasion* § 10.2-3. We are also mindful that prior to the enactment of the 1954 Int. Rev. Code, the penalty for a deficiency due to negligence or intentional disregard of rules and regulations was denominated "Negligence." It is conceivable that the Tax Court's finding that a negligence penalty was properly assessed or that negligence occurred was its shorthand method of saying that both parts of Section 6653(a) were violated. Such conciseness would be understandable in light of the terminology employed in the predecessors to Section 6653(a). We do not rest on this interpretation of the Tax Court's finding, it being more proper to answer the taxpayers specific arguments than cavalierly to avoid them. See Section 293(a), Rev. Act 1928; Section 293(a) of the 1939 Int. Rev. Code, 26 U.S.C.A. 293(a) (1939 Code). See Robinson's Dairy, Inc. v. Commissioner, 10 Cir. 1962, 302 F.2d 42, for the use of the term "negligence," though the penalty assessed was for negligence or intentional disregard of rules and regulations.

[27] "The assessment of a negligence penalty is a purely administrative act dependent upon a finding of the extent of negligence." Board v. Commissioner, 6 Cir. 1931, 51 F.2d 73, 76. See Bothwell v. Commissioner, 10 Cir. 1935, 77 F.2d 35, 38; Gouldman v. Commissioner, 4 Cir. 1948, 165 F.2d 686, 690. See Rules of Practice, Tax Court Rule 32, 26 U.S.C.A.

[28] Humphrey's Estate v. Commissioner, 5 Cir. 1947, 162 F.2d 1; *cert. den.*, 332 U.S. 817; Tehan v. C.I.R., 7 Cir. 1961, 295 F.2d 895; Cf. William S. Blomely, Jr., T.C. Memo 1964-84.

The Commissioner's determination shifts the burden of going forward to the taxpayer.[29] After the taxpayer produces his evidence, the Commissioner may elect to produce no rebuttal evidence, being content that the taxpayer has not shown the Commissioner's determination to be erroneous. The Tax Court is then free to reach its decision on the basis of whether the entire record indicates that the Commissioner's determination was in error.[30] The Tax Court will consider two factors in making its decision: (1) that the Commissioner's determination at the beginning of the proceedings was presumed to be correct, and (2) that the burden of proof at the close of the proceedings still remains with the taxpayer to establish the Commissioner's errors by a preponderance of the evidence. We find that the Tax Court ably and correctly performed its task.[31]

VII. Sale of Inherited Property Reported on the Installment Basis.

The various taxpayers inherited property from Joseph Marcello, Sr. The property was sold in 1958 to several corporations, but no gain was reported

[29] Welch v. Helvering, 1933, 290 U.S. 111; Wickwire v. Reinecke, 1927, 275 U.S. 101; C.I.R. v. Smith, 5 Cir. 1960, 285 F.2d 91, 95, et seq.

[30] If the Commissioner presents rebuttal testimony, the Tax Court takes such testimony into consideration.

[31] For a discussion on the burden of proof, see Balter, *Tax Fraud and Tax Evasion* §§ 10.3-1 thru 10.4-7. See also, Copelan, "Practical Problems on Burden of Proof in Civil Trials," 10 N.Y.U. Inst. on Fed. Tax. 865 (1951); 9 Mertens, Law of Federal Income Taxation § 50.61, et seq.; Ness, "The Role of Statutory Presumptions in Determining Federal Tax Liability," 12 Tax. L. Rev. 321 (1957).

on any personal tax return and no election to report income on the installment basis was made. In 1962 a Form 1042 (United States Fiduciary Income Tax Return) in the name of Estate of Joseph Marcello, deceased, was filed by Carlos Marcello in which some of the sale proceeds were reported and an election to use the installment method[32] was made. The taxpayers contend that this 1962 return and election enables them to use the installment method to report their own shares of the gains from the sale. The taxpayers argue that Carlos acted as agent for each of the other taxpayers and his election on the fiduciary return is, in effect, an election for each of them.

The taxpayer wishing the benefit of installment reporting must make an election on his return either for the year of the sale[33] or for the year when the first payment is received.[34] This latter time for making the election was approved by Rev. Rul. 65-297. The taxpayers request that this case be remanded so that the Tax Court can apply the new ruling.

The Commissioner contends that, despite the new ruling, the taxpayers should be given no relief. The Commissioner suggests that the fiduciary return was filed for a separate taxpayer, the Estate of Joseph Marcello, Sr., and therefore cannot be the means to make an election for the individual taxpayers. There was no express finding as to the effect or purpose of the "fiduciary return." If Carlos filed the return

[32] Section 453; Int. Rev. Code (1954), 26 U.S.C.A. 453.
[33] Regulation 1.453-8 (b).
[34] Rev. Rul. 65-297, Cum. Bull. 1965-2, 152.

as agent for the individual taxpayers, it may be that they are bound by all that appears on the return.[35] On the other hand, the fiduciary return may have served no significant purpose and may not be binding on the individual taxpayers. In light of the new ruling, we think it proper for the Tax Court to determine the effect of the fiduciary return.

AFFIRMED IN PART AND REMANDED IN PART.

[35] If the return is binding on all the taxpayers, they would reap any benefits that an installment election would bring. The Commissioner suggests that if a taxpayer had a large loss in 1958 and, therefore, wanted to report all of his share of the sale in that year, the fiduciary return's election could not prevent him from so doing. We are not so sure, for if the fiduciary return is binding, it may be binding for better or for worse.

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APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 23152

* * *

Before RIVES, COLEMAN and GODBOLD, Circuit Judges.

JUDGMENT

This cause came on to be heard on the petitions of Carlos & Jacqueline Marcello, Et Al., for review of decisions of the Tax Court of the United States, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered, adjudged and decreed by this Court that the decision of the Tax Court in this cause be, and the same is hereby, affirmed in part, and that this cause be, and same is hereby remanded to the Tax Court in accordance with the opinion of this Court.

June 16, 1967

Issued as Mandate: SEP 8 1967

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 23152

* * *

Petitions for Review of Decisions of the Tax Court of the United States (Louisiana Case)

(August 29, 1967)

PETITION FOR REHEARING EN BANC
PETITION FOR REHEARING

Before RIVES, COLEMAN and GODBOLD, Circuit Judges.

PER CURIAM:

The Petition for Rehearing is DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, Rule 25(a), subpar. (b), the Petition for Rehearing En Banc is DENIED.

APPENDIX D

TAX COURT OF THE UNITED STATES

MEMORANDUM FINDINGS OF FACT AND OPINION

(Filed November 18, 1964)

DAWSON, Judge

* * *

Issue 4

Gain on Sale of Personal Residence - Carlos and Jacqueline

On July 31, 1946, Carlos purchased a residence at 800 Barataria Boulevard, Marrero, Jefferson Parish, Louisiana, for $42,500. The 1956 and 1957 Federal income tax returns of Carlos and Jacqueline reflect that Carlos and his family occupied this residence in those years. Carlos and Jacqueline sold their Barataria Boulevard residence in 1958. In a schedule attached to their joint income tax return for the year 1958, the sale of the residence was reported as follows:

SALE OF RESIDENCE

Sold to: Anthony Ragusa, 12/5/58 (Net)		$ 84,963.85
House note		17,000.00
Total Selling Price		$101,963.85(1)
Cost of Residence	$42,500.00	
Improvements	10,000.00	$ 52,500.00

(1) This is being reported in accordance with the 1954 Code; reference sale of residence-subject requirements will be complied with.

An Act of Sale dated March 31, 1958, reflects that Louisa purchased in her name a residence at 577 Woodvine Street, Metairie, Louisiana, for $110,000, all of which is shown as paid. At the time of this purchase, Louisa executed the mortgage on the Woodvine property in favor of W. R. White, securing her promissory note in the amount of $73,-000, payable to W. R. White. In a notarized and witnessed affidavit sworn to on March 31, 1958, Louisa deposed that: The title to the Woodvine residence property was placed in her name for convenience only; the property was bought by and for the account of Carlos, by whom the whole of the purchase price was paid; she agreed to bind herself, her heirs, executors, and administrators to convey said property by proper title and due form of law, to said Carlos, his heirs, executors, and assigns whenever required to do so; and, in making said conveyance, no price or consideration is to be paid though one might be stipulated and declared to be paid in the deed of conveyance. A passbook of The First National Bank of Jefferson carried in the name of Louisa shows periofic payments of principal and interest on the mortgage in 1958, 1959 and 1960. The periodic payments were actually made by Carlos and Jacqueline out of their funds and the interest paid was as follows:

1958	$2,428.61
1959	3,372.75

Issue 5

Disallowed Deductions
Carlos and Jacqueline

* * *

In 1957 and 1958, Carlos paid respective amounts of $2,361.87 and $2,238.40 to Jack Wasserman for legal fees in connection with pending proceedings before the Commission of Naturalization and Immigration relating to the deportation of Carlos.

In 1957 Carlos paid $3,108 to Dean Andrews, an attorney, but no evidence was offered concerning the purpose of the expenditures. In 1958 Carlos paid $1,000 to Albert Koorie, an attorney, for services rendered in connection with Carlos, tax matters.

In the year 1959 Carlos and Jacqueline reported rental income in the amount of $2,400 and $975 from property known as Old Southport and New Southport, respectively. Petitioners' claim for additional depreciation of $2,799.63 in 1959 in connection with these properties was denied by respondent.

† † †

Issue 4

Gain on Sale of Residence

Carlos and Jacqueline contend that they are entitled to postpone the recognition of gain realized by them in 1958 on the sale of their residence under the provisions of section 1034, Internal Revenue Code of 1954.

The evidence shows that the petitioners sold the home which was their principal residence at 800 Barataria Boulevard in 1958 and that in the same year a house at 577 Woodvine Street was purchased in the name of Louisa, Carlos' mother. Louisa held record legal title to this new property for the years in issue, although it was apparently used as the residence of Carlos and Jacqueline. Louisa executed an affidavit in which she averred that the title to the property was in her name for convenience only; that the property was bought by and for Carlos; and that she agreed to bind herself to convey the title to Carlos whenever required to do so.

Petitioners argue that the document executed by Louisa was a "counter letter" and that under Louisiana law the statements contained in the document are entitled to judicial recognition. Petitioners offered no independent proof

as to the facts averred to in the affidavit, and there is nothing, apart from the affidavit, to show that Carlos was the actual purchaser of the residence at 577 Woodvine Street. There was no testimony from Carlos, Jacqueline or Louisa at the trial. Thus, the establishment of the truth of the facts argued by petitioners hinges on the acceptance of Louisa's *ex parte* affidavit and the alleged facts averred to therein.

The term "counter letter" is defined as an agreement to reconvey where property has been passed by absolute deed with the intention that it shall serve as security only. *Standard Oil Co. of Louisiana v. Futral*, 204 La. 215, 15 So. 2d 65, 73 (1943). Since the affidavit executed by Louisa was not an agreement to reconvey, nor was it offered for security, the document, in our opinion, does not qualify as a "counter letter" under Louisiana law. See *Karcher v. Karcher*, 138 La. 288, 70 So. 228 (1915); *Canella v. Canella*, 40 So. 2d 377 (La. App. 1950); and *Swartz v. Friedenburg*, 135 So. 2d 371 (La. App. 1961). Hence we consider it to be a mere *ex parte* affidavit, which is not acceptable as evidence by us under Rule 31(f), Tax Court of Practice, or under the hearsay rule. Even if we assumed that the instrument is a "counter letter" and is admissible of the facts alleged therein, it is inoperative under Louisiana law as to third parties until filed for registry in the office of the Parish Recorder. Title 9, Sec. 2721, La. Rev. Stats. of 1950; and *State ex. rel. Herbert v. Recorder of Mortgages*, 175 La. 94, 143 So. 2d 15 (1951). There is no evidence that the instrument was ever recorded in Jefferson Parish. We must therefore conclude that petitioners have failed to establish the facts necessary for us to decide the potential legal question involved as to the application of section 1034 to situations where recorded title is not in the name of the actual purchaser.

Consequently, we hold that the gain is to be recognized because of petitioners' failure to meet their burden of proof.

The gain should be computed as follows:

Total sales price	$103,963.85
Basis	42,500.00
Gain	$ 61,463.85

Petitioners have failed to offer any evidence as to the alleged cost of improvements of the old residence shown on their return as totaling $10,000, so that the cost basis of $42,500 must be used as determined by respondent.

It follows that the claimed interest deductions paid by Carlos and Jacqueline in 1958 and 1959 must also be denied for lack of proof. As far as the record establishes, we must assume that the interest was paid on behalf of Louisa for her debt on the mortgage and it cannot be deducted by petitioners.

Issue 5

Disallowed Deductions
Carlos and Jacqueline

* * *

Furthermore, the attorney fees paid by Carlos in resisting deportation are personal and not deductible. Such expenses are not directly related to the production or collection of income or to the management, conservation or maintenance of property. We do find, however, that the attorney fees of $1,000 paid in 1958 for representation in tax matters are deductible in that year under the provisions of section 212 (3).

* * *

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 847

CARLOS AND JACQUELINE MARCELLO, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The petition for certiorari in this federal income tax case presents two issues: (1) whether attorney's fees Carlos Marcello paid in resisting deportation are deductible under Section 162(a) or 212 of the 1954 Internal Revenue Code as ordinary and necessary expenses incurred in business or in the production of income; and (2) whether the petitioners are entitled under Section 1034(a) of the Code to postpone recognition of gain they realized on sale of their residence. The Tax Court held for the Commissioner on both issues (Pet. A22–A24), and the court of appeals affirmed (Pet. A2–A4, A7–A9).[1]

[1] The opinion of the court of appeals is reported at 380 F. 2d 499.

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The decision is correct, and presents no question of general importance. There is no conflict or other reason for further review.

1. The deportation proceedings in the 1950's against Carlos Marcello arose out of his 1938 criminal conviction for transferring marihuana. Petitioners failed to prove, however, that those transfers comprised part of his business or income-producing activities. Thus, petitioners have not shown that even counsel fees incurred in defending the criminal prosecution would have been deductible on the theory that such prosecution had its "origin and character" in income-producing activities under the rule of *Commissioner* v. *Tellier*, 383 U.S. 687, 689. *A fortiori*, they have not shown that the counsel fees incurred in the subsequent deportation proceedings bore such a relationship to income-producing activities. Moreover, it is doubtful whether a deportation proceeding based upon a conviction growing out of income-producing activities has a sufficiently close relationship to those activities to justify deduction of counsel fees incurred in such proceeding. That deportation would have terminated the income producing activities of Carlos Marcello in the United States does not warrant the deduction. Compare *United States* v. *Gilmore*, 372 U.S. 39. In the circumstances, the courts below were justified in treating the fees in question as nondeductible personal expenses. See Section 262 of the Code.

2. Section 1034(a) provides for nonrecognition of gain on the sale or exchange of property used as a principal residence where the taxpayer purchases and uses a new residence within specified time limits. Pe-

tioners sold their residence and then went to live in a house that Carlos' mother had purchased in her own name. The courts below were not required, as petitioners contend, to accept as conclusive proof of Carlos' ownership an affidavit that his mother executed, but never recorded,[2] to the effect that Carlos was the real purchaser of the property. There was no corroborative evidence. With the record in this inconclusive state, the courts below were certainly warranted in holding that the petitioners failed to discharge their burden of proof.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

MITCHELL ROGOVIN,
Assistant Attorney General.

DAVID O. WALTER,
LORING W. POST,
Attorneys.

DECEMBER 1967.

[2] See 3A West's Louisiana Statutes Annotated, Revised Statutes, Section 9.2721, which deprives such an unrecorded affidavit of any binding effect as to third parties.

U.S. GOVERNMENT PRINTING OFFICE: 1967